

Farmer X irrigates 160 acres of owned land in District A as he is entitled to do. Subsequent to his determination of eligibility, Farmer X buys, in District B, a 160-acre farm which is also receiving irrigation water. All land purchased by Farmer X in District B thereby becomes ineligible for service until such time as Farmer X either redesignates the land as nonexcess, cancels the sale, sells the farm in District B at a price approved by the Secretary, or he makes the land eligible by electing to come under the discretionary provisions. If the 160 acres which Farmer X purchased had never received irrigation water and were in an area for which water distribution facilities had not been constructed, Farmer X could, as provided for in § 426.11(e), place the 160 acres under recordable contract when the facilities became available to serve the land.

[52 FR 11954, Apr. 13, 1987, as amended at 53 FR 50535, Dec. 16, 1988]

§ 426.7 Leasing and full-cost pricing.

(a) *What constitutes a lease.* A lease is a contract by which one party (the landlord or lessor) gives to another (the tenant or lessee):

(1) The use and possession of land (including, in some cases, associated buildings, machinery, etc.);

(2) For a specified time.

(3) For agreed upon payments (cash or other consideration); and

(4) The lessee assumes the economic risk in the operation and management of the leased land.

(1) *Exceptions.* (i) Management arrangements or consulting agreements in which (1) the manager or consultant performs a management or consulting service for the landowner for a fee but does not assume the economic risk in the farming operation, and (2) the landowner retains the right to the use and possession of the land, is responsible for payment of the operating expense, and is entitled to receive the profits from the farming operation, shall not be considered a lease. At the Secretary's request, the landowner shall be responsible for providing information concerning a farm management arrangement or a consulting arrangement.

(A) The application of this rule may be illustrated as follows:

Example (1). (a) Farmer W is a surviving spouse who has elected under the discretionary provisions and receives irrigation water on 960 acres in District A. Her son,

Farmer S, is subject to prior law and owns and receives water on 160 acres, also in District A. (b) In addition to farming his own 160 acres, Farmer S operates Farmer W's equipment in performance of all the physical farm work on his mother's 960 acres and receives compensation for such services, which does not consist of a share of the crop or is not based, in advance, on the degree of economic success or failure of the production or marketing of the crop. Farmer W retains at all times the economic risk associated with both crop production and marketing from her 960 acres. Such an arrangement between Farmer W and Farmer S constitutes a farm management arrangement and not a lease.

Example (2). Same facts as in example (1), part (a). In addition to farming his own 160 acres, Farmer S has use and possession of his mother's land and utilizes his farm equipment in the operation of his mother's farm in exchange for a fee. The fee received by Farmer S depends materially upon the degree of economic success or failure of the crop production or marketing of the crops grown on his mother's farm. This arrangement between Farmer W and Farmer S constitutes a lease and not a farm management arrangement or agreement.

(ii) Nonreclamation dependent activities. A contract arrangement for nonreclamation dependent activities which allow for limited use of the land shall also not be considered a lease. Examples of such activities are incidental grazing or use of crop residue from irrigated crops grown on the land.

(b) *The form and provisions of a lease—*

(1) *Present leases.* All leases must be in writing and made available by the leaseholders to the Secretary for inspection at the Secretary's request. The term of the lease may not exceed 10 years, including any exercisable option, except in the case of a lease of land for the production of perennial crops having an average life of more than 10 years. In that case, the lease may be for a period of time equal to the average life of the perennial crop, as determined by the Secretary, provided the lease does not exceed 25 years.

(2) *Written leases in existence prior to October 12, 1982.* Land under written leases which were in existence prior to October 12, 1982, and which have a remaining term of longer than 10 years will become ineligible to receive irrigation water after October 12, 1992, unless

the leased land is used for the production of perennial crops having an average life of more than 10 years. In that case, the leased land may be eligible for a period of time equal to the average life of the perennial crop, as determined by the Secretary, provided the lease does not exceed 25 years.

(c) *Full-cost acreage thresholds.* There is a limit on the amount of land for which a landholder may receive irrigation water at a non-full-cost rate. The maximum acreage a landholder may irrigate with less-than-full-cost irrigation water is called the landholder's non-full-cost entitlement. All owned or leased land receiving irrigation water counts against a landholder's non-full-cost entitlement, with the following exceptions: Exempt land, except for isolated tracts, as provided in § 426.13(a)(4); and land acquired through involuntary processes, as provided in § 426.16. All land counted against a landholder's non-full-cost entitlement shall be counted on a cumulative basis during any one water year. A landholder in excess of the non-full-cost entitlement may select in each water year, from nonexempt eligible land in the holding, that land which will be subject to the full-cost rate. That selection may include owned land, leased land, land under recordable contract, or a combination of all three. However, land under recordable contract may not be selected as land subject to the full-cost rate if such land is already subject to full-cost pricing under an extended recordable contract as provided in § 426.11(i)(4). Once a landholder reaches the limits of his or her non-full-cost entitlement during a water year, the selection of non-full-cost land is binding for the remainder of that water year. Land subject to full-cost pricing due to the status of either the owner or the lessee can receive irrigation water only at full cost. Districts shall collect full-cost rates from those landholders to whom such costs are attributable rather than averaging the costs over the entire district. Land which is subleased (the lessee transfers his or her interest to a sublessee) will be attributed to the landholding of the sublessee.

(1) *Non-full-cost entitlement for qualified recipients.* The non-full-cost entitlement

for qualified recipients is 960 acres, or the class 1 equivalent thereof, computed on a cumulative basis during any one water year. The full-cost rate must be paid for irrigation water delivered to all eligible land owned or leased in excess of a qualified recipient's non-full-cost entitlement, except for (i) land subject to a recordable contract unless as otherwise provided in §§ 426.11(e) and 426.11(i)(4); (ii) exempt land other than isolated tracts, as provided in § 426.13(a)(4); and (iii) land acquired through involuntary processes, as provided in § 426.16.

(i) The application of this rule may be illustrated as follows:

Example (1). Farmer X, a qualified recipient, receives irrigation water on 900 of the 960 acres of irrigable land in his ownership in District A. Farmer X leases and receives irrigation water on another 320 acres in District B. Since Farmer X receives water on 260 acres in excess of his non-full-cost entitlement, he must select 260 acres—whether owned land, leased land, or a combination of both, and pay the full-cost rate for water delivered to that land.

Example (2). Farmer Y, a qualified recipient, owns and receives irrigation water on 960 acres in District A. Farmer Y decides to lease all 960 acres to another qualified recipient, Farmer Z. Farmer Z, however, already farms 960 acres receiving irrigation water. Therefore, the full-cost rate would have to be paid for irrigation water delivered to 960 acres of Farmer Z's landholding.

Example (3). Landholder X, a qualified recipient, owns 500 acres of irrigation land in District A which he leases to another farmer. Landholder X also leases 960 acres of irrigation land from Landholder Y in District B. Thus, there are 500 acres in Landholder X's total landholding which receive irrigation water in excess of his 960-acre non-full-cost entitlement and for which a full-cost rate must be paid.

Example (4). Landholder Y, a qualified recipient, receives irrigation water on 960 acres owned in District A and 800 acres leased in District B. At the beginning of the water year, Landholder Y selects 360 owned acres plus 600 leased acres to receive irrigation water at the non-full-cost rate. He pays the full-cost rate for water delivered to the remaining 800 acres. In July, Landholder Y terminates the lease on the 600 acres of leased land which are part of his non-full-cost entitlement. However, since non-full-cost acreage is counted against one's entitlement on a cumulative basis during any one water year, Landholder Y has already reached the limits of his non-full-cost entitlement for this water year. Therefore, Landholder Y

may not replace in that water year those 600 non-full-cost acres, even though they no longer receive irrigation water, with 600 acres from his full-cost land. Landholder Y must pay the full-cost rate for irrigation water delivered to any other land he irrigates during that water year.

Example (5). Landholder Z, a qualified recipient, owns and irrigates 1,120 acres, 160 of which are subject to a nonextended recordable contract. Landholder Z also irrigates 160 acres leased from another party. All of Landholder Z's landholding, a total of 1,280 acres, counts against his non-full-cost entitlement; therefore, he is in excess of his non-full-cost entitlement by 320 acres. However, the 160 acres under recordable contract are not subject to full-cost pricing, so Landholder Z need select only 160 acres from his total landholding for full-cost pricing.

(2) *Non-full-cost entitlement for limited recipients.* The non-full-cost entitlement for limited recipients that received irrigation water on or before October 1, 1981, is 320 acres or the class 1 equivalent thereof. The non-full-cost entitlement for limited recipients that did not receive irrigation water on or prior to October 1, 1981, is zero. The full-cost rate must be paid for irrigation water delivered to all eligible land owned or leased in excess of a limited recipient's non-full-cost entitlement, except for (i) land subject to a recordable contract unless as otherwise provided in § 426.11 (e) and (i)(4); (ii) exempt land other than isolated tracts, as provided in § 426.13(a)(4); and (iii) land acquired through involuntary processes, as provided in § 426.16.

(i) The application of this rule may be illustrated by the following:

Example (1). ABC Farms qualifies as a limited recipient but remains under prior law. It owns and was receiving irrigation water on 640 acres in District A prior to October 1, 1981. Of the total, 480 acres were and continue to be under a nonextended recordable contract. ABC Farms may continue to receive irrigation water at the non-full-cost rate on the 640 acres until the end of the recordable contract period. Upon electing, ABC Farms may amend the recordable contract to allow it to own and receive irrigation water on 640 acres owned. ABC Farms may receive irrigation water at the non-full-cost rate on 320 acres, but it must pay the full-cost rate on the additional 320 acres owned.

Example (2). XYZ Farms, a limited recipient, owns 640 acres of land eligible to receive irrigation water. The purchase of the land took place after October 1, 1981, and XYZ Farms was not receiving irrigation water on

any other land on or before October 1, 1981. Therefore, in order for XYZ Farms to receive irrigation water for any eligible land, it must pay the full-cost rate for that water.

Example (3). FGH Fertilizer Company, a limited recipient, buys 160 acres of land receiving irrigation water in District A. The purchase of the land is made subsequent to October 1, 1981. However, the company was receiving irrigation water on 160 leased acres in District B prior to October 1, 1981. Therefore, the 160 acres recently purchased are eligible to receive irrigation water at the non-full-cost rate. If FGH Fertilizer Company buys or leases additional land, the company would have to select and pay the full-cost rate for any irrigation water delivered to land in excess of its 320-acre non-full-cost entitlement.

Example (4). The XYZ Corporation, a limited recipient, owns 640 acres of irrigation land in District A. Since the corporation was receiving irrigation water prior to October 1, 1981, it is entitled to irrigate 320 acres at the non-full-cost rate and 320 acres at the full-cost rate. If the corporation were to lease the owned land subject to full cost to another, the full-cost rate would still apply.

(3) *Non-full-cost entitlement for prior law recipients.* There is no full-cost pricing requirement until April 13, 1987, for prior law recipients, unless their land becomes subject to full-cost pricing through leasing to or from a party subject to the discretionary provisions. As of April 13, 1987, the full-cost rate must be paid for irrigation water delivered to all land leased in excess of a prior law recipient's maximum ownership entitlement as set forth in § 426.6(d); provided however, that for the purpose of computing the acreage subject to the full-cost rate, all owned and leased land receiving water westwide must be considered and further provided, that the full-cost rate will not apply to water delivered to land in excess of a prior law recipient's non-full-cost entitlement if the land is (i) subject to a recordable contract unless as otherwise provided in § 426.11 (e) and (i)(4); (ii) exempt other than isolated tracts, as provided in § 426.13(a)(4); (iii) acquired through involuntary processes, as provided in § 426.16.

A prior law recipient may select the land to be subject to full cost from any owned or leased land in his landholding, provided it is eligible and non-exempt.

(i) The application of this rule may be illustrated by the following:

Example (1). Farmer X and his wife receive irrigation water on 320 owned acres of irrigation land and on 40 leased acres in District A. District A has not amended its contract to become subject to the discretionary provisions and Farmer X and his wife have not made an irrevocable election. Since Farmer X and his wife receive irrigation water on 40 acres in excess of their 320-acre non-full-cost entitlement, the couple must select 40 acres in their landholding and, beginning April 13, 1987, pay the full-cost-rate for water delivered to that land. If Farmer X and his wife make an irrevocable election or if District A amends its contract to become subject to the discretionary provisions, the couple would thereby become a qualified recipient with a non-full-cost entitlement of 960 acres. Since their landholding is within that entitlement, Farmer X and his wife would be able to receive irrigation water at the non-full-cost rate on all 360 acres.

Example (2). Farmer X and his wife lease 640 acres of irrigation land in District A and another 640 acres of irrigation land in District B. Districts A and B have not amended their contracts to become subject to the discretionary provisions and Farmer X and his wife have not made an irrevocable election. Since there are 960 acres of land in excess of the couple's 320-acre non-full-cost entitlement, Farmer X and his wife must select 960 acres in their landholding and, beginning April 13, 1987, pay the full-cost rate for water delivered to that land.

Example (3). Four brothers hold equal and separable interests in a partnership they formed. The partnership owns 160 acres of irrigation land in District A and also leases another 320 acres from Farmer Y in District B. The partnership and Districts A and B remain subject to prior law. Since the partnership's landholding is within its 640-acre non-full-cost entitlement (160 x 4), no full-cost charges will be assessed to water delivered to any land in the holding.

Example (4). Farmer X, a prior law recipient, owns 5,000 acres of irrigation land in District A, 4,840 of which are under recordable contract. He receives irrigation water also on another 320 acres which he leases in this same district. Beginning on April 13, 1987, Farmer X will be receiving irrigation water on 5,160 acres (5,320–160) in excess of his non-full-cost entitlement. However, his recordable contract land is not subject to full-cost pricing; therefore, Farmer X must select 320 acres (5,160–4,840) for full-cost pricing. Although his recordable contract land is not subject to full-cost pricing, Farmer X may, at his option, select part or all of the 320 full-cost acres from the land under recordable contract in lieu of his nonexcess or leased land.

(d) *Multidistrict landholding.* If a landholder has multidistrict landholdings,

only one of those districts in which he receives irrigation water needs to amend its contract for the landholder to automatically become a qualified or limited recipient and the landholder's owned and/or leased land receiving irrigation water in all districts to become subject to the discretionary provisions. Furthermore, a qualified or limited recipient remains such a recipient even after he disposes of his ownership or leasehold interest in land within a district subject to the discretionary provisions. An amendment by a district is also binding on legal entities with landholdings within a district but is not binding on the members of the legal entity as to their landholdings outside the legal entity and outside the district. In no case, however, shall a prior law recipient become a qualified or limited recipient by virtue of leasing irrigation land from a lessor who has made an irrevocable election.

(e) *Calculating full cost*—(1) *What constitutes full cost.* As set forth in § 426.4, the term “full cost” means an annual rate as determined by the Secretary that shall amortize the expenditures for construction properly allocable to irrigation facilities in service, including all operation and maintenance deficits funded, less payments, over such periods as may be required under Federal Reclamation law or applicable contract provisions, with interest on both accruing from October 12, 1982, on costs outstanding at that date, or from the date incurred in the case of costs arising subsequent to October 12, 1982. Operation, maintenance, and replacement charges required under Federal Reclamation law shall be collected in addition to the full-cost payment.

(i) *Amortization period.* The amortization period for calculating the full-cost rate shall be the remaining balance of the repayment period for the district as specified in its repayment contract. However, in those cases, such as in water service contracts, where payment by a district through its existing contract term will not fully discharge its obligation for repayment of construction costs and where, in accordance with the project authorization the district must renew its water service contract, the district may extend the amortization period for the calculation

of full costs by renegotiating its current water service contract at the time it amends its contract to conform to the discretionary provisions. The amortization period may extend up to the expiration date of the new contract, and the term of the new contract cannot exceed the payback period authorized by Congress. In cases where water services rates are designed to completely repay applicable Federal expenditures in a specific time period, that time period may be used as the amortization period for full-cost calculations related to these expenditures. Such an amortization period may not exceed the payback period authorized by Congress.

(ii) *Allocable construction expenditures.* For determining full cost, the construction costs properly allocable to irrigation are those Federal project costs which have been assigned to irrigation within the overall allocation of total project construction costs. Total project construction costs include all direct expenditures necessary to install or implement a project, such as planning, design, land, rights-of-way, water-rights acquisitions, construction expenditures, interest during construction, and when appropriate, transfer costs associated with services provided from other projects.

(iii) *Facilities in service (irrigation).* Facilities in service are those facilities which are in operation and providing irrigation services.

(iv) *Operation and maintenance deficits funded.* O&M deficits funded are the annual O&M costs including project-use pumping power allocated to irrigation which have been federally funded and which have not been paid by the irrigation contracting entity.

(v) *Payments.* In calculating the payments which have been received, all receipts and credits applied to repay or reduce allocated irrigation construction costs in accordance with Reclamation law, policy, and applicable contract provisions shall be considered. These may include: (A) direct repayment contract revenues, (B) net water service contract income, (C) contributions, (D) ad valorem taxes, and (E) other miscellaneous revenues and credits excluding power and M&I (municipal and industrial) revenues.

(vi) *Unpaid balance.* The unpaid balance is the irrigation allocated construction costs plus cumulative federally funded O&M deficits, less payments.

(2) *Calculating the full-cost rate.* The Secretary will calculate a district's full-cost rate using accepted accounting procedures. The definition of "full cost" contained in title II does not recover interest charges retroactively before October 12, 1982, but interest charges on the unpaid full cost do accrue from the date of the act. The full-cost rate for amended contracts will be determined as of the date of enactment. The full-cost rate for districts which enter into contracts after the date of enactment will be determined at the time the new contract is executed. For repayment contracts, the full-cost rate will fix equal annual payments over the amortization period. For water service contracts, the full-cost rate will fix equal payments per acre-foot of projected water deliveries over the amortization period. If there are additional construction expenditures or the cost allocated to irrigation changes, then a new full-cost rate will be determined. The Secretary will notify the respective districts of changes in the full-cost rate at the time he notifies the district of other payments due the United States.

(i) The application of this rule may be illustrated by the following:

Example (1). District A contains 90,000 irrigable acres. The construction costs allocated to irrigation for the project and to be repaid by District A amount to \$240 million. As of October 12, 1982, the district's accumulated repayments are \$174 million, the unpaid obligation on District A's repayment contract is \$66 million, and 11 years remain on its contract term. The established annual contract rate is \$66.67 per acre. This amount repays the outstanding balance of the contractual obligation in 11 years. As of October 12, 1982, the unpaid balance for full cost is \$66 million (allocated cost, less payments) or \$733.33 per acre, and the applicable interest rate is determined to be 7½ percent. Therefore, the equal annual payments for full cost would be \$100.24. This payment is calculated using standard amortization tables and is equivalent to the annual payment necessary to retire a debt of \$733.33 at a 7½ percent rate of interest over 11 years. This rate will apply regardless of when District A amends its contract.

Example (2). District B has a water service contract which establishes a rate of \$6.50 an acre-foot for 90,000 acre-feet of water delivered to the district, a rate which is fixed over the remaining 10 years of the contract term. Currently, \$1.00 of the \$6.50 rate is used to pay annual O&M charges. The remainder is credited to the repayment of irrigation construction costs, although inflation over the next 10 years is expected to leave a \$5.00 per acre-foot payment to irrigation, averaged over the remaining 10 years. The construction costs to be repaid from irrigation revenues and assignable to be repaid by the land in District B are \$24 million, and the district has paid \$15.5 million of those costs to date.

As of October 12, 1982, the accumulated payments credited to repayment on construction are \$15.5 million. The unpaid balance for full cost is \$8.5 million (\$24 million less \$15.5 million), and the applicable interest rate is determined to be 7½ percent. Amortizing the unpaid balance over the remaining contract term of 10 years results in an annual full-cost rate of \$1,384,016, or \$15.38 per acre-foot. Normal O&M charges would be collected annually in addition to this rate.

Upon expiration of the current contract, the district expects to enter into a subsequent water service contract in order to expand its water deliveries. If District B desires to amortize its unpaid balance for full cost over a longer period than 10 years, it can choose to renegotiate its existing contract before the current contract expires to bring it into conformance with current Bureau policy. When the district renegotiates its contract, the unpaid balance for full cost could be reamortized, at the district's option, for any period up to the term of the new water service contract, which cannot exceed the repayment period authorized by Congress. For example, suppose the new water service contract runs for 18 years and is executed immediately. If the district chooses to amortize full cost over the longest permissible repayment period (18 years), then the full-cost rate would be \$10.88 per acre-foot. If the district chooses to amortize over 15 years, the full-cost rate would be \$11.96 per acre-foot, assuming the unpaid costs remain the same.

Example (3). District C contains 90,000 irrigable acres, and the construction costs allocated to irrigation for the project and assignable to be repaid amount to \$240 million. As of October 12, 1982, the accumulated repayments of the district are \$174 million. The district's repayment obligation is \$200 million. (The \$40 million difference between construction costs allocated to irrigation and the repayment obligation is scheduled to be paid from other project revenues.) The unpaid obligation on District C's repayment contract is \$26 million, and 11 years remain on its contract term. The annual rate estab-

lished by the contract is \$26.26 per acre. This amount repays the outstanding balance of the contractual obligation in 11 years. As of October 12, 1982, the unpaid balance for full cost is \$66 million (allocated cost, less payments) or \$733.33 per acre, and the applicable interest rate is determined to be 7½ percent. Therefore, the equal annual payment for full cost would be \$100.24 per acre.

Example (4). District D has a 40-year water service contract for 90,000 acre-feet of water per year. The District's current contract expires in 1997 and will be renewed for another 40-year term, resulting in an expiration date of 2036. Construction costs assigned to District D are \$24 million, and such costs are to be repaid from irrigation water service revenues. As of October 12, 1982, the accumulated payments credited to construction costs are \$15.5 million. The unpaid balance for full cost is \$8.5 million and the applicable interest rate is determined to be 7½ percent. Water service rates for this project are designed to completely repay applicable expenditures by the end of the authorized repayment period, which occurs in 2030. Amortizing the unpaid balance over the remaining authorized repayment period of 48 years results in an annual full-cost charge of \$657,945 or \$7.31 per acre-foot. Normal O&M charges would be collected annually in addition to this rate. It should be noted that even though the contract renewal extends beyond 2030, the repayment period is limited to the authorized repayment period ending 2030, with full-cost rates calculated accordingly.

(f) *Interest rate calculations for full cost.* In determining full cost, the interest rates to be used will be determined by the Secretary of the Treasury as follows:

(1) Interest rates applicable to (i) qualified recipients, (ii) limited recipients receiving water on or before October 1, 1981, and (iii) extended recordable contract land owned by prior law recipients after December 22, 1987.

(A) The interest rates for expenditures made on or before October 12, 1982, shall be the greater of 7½ percent per annum or the weighted average yield of all interest-bearing marketable issues sold by the Treasury during the fiscal year in which the expenditures were made by the United States.

(B) The interest rate for expenditures made after October 12, 1982, shall be the arithmetic average of (1) the computed average interest rate payable by the Treasury upon its outstanding marketable public obligations which are neither due nor callable for redemption for 15 years from the date of issuance

at the beginning of the fiscal year in which the expenditures are made and (2) the weighted average yield on all interest-bearing marketable issues sold by the Treasury during the fiscal year preceding the fiscal year in which the expenditures are made.

(2) Interest rates applicable to (i) limited recipients not receiving irrigation water on or before October 1, 1981, and (ii) prior law recipients, except for land owned under extended recordable contract after December 22, 1987. The interest rate shall be determined as of the fiscal year preceding the fiscal year in which expenditures are made except that the interest rate for expenditures made before October 12, 1982, shall be determined as of October 12, 1982. The interest rate shall be based on the arithmetic average of (A) the computed average interest payable by the Treasury upon its outstanding marketable public obligations which are neither due nor callable for redemption for 15 years from the date of issuance and (B) the weighted average yield on all interest-bearing marketable issues sold by the Treasury.

NOTE: Prior law recipients who become subject to the discretionary provisions after April 12, 1987, will then become eligible for the full-cost interest rate specified in paragraph (f)(1) of this section, unless they are limited recipients that did not receive irrigation water on or before October 1, 1981.

(g) *Proportional charges for full-cost water.* Methods for assessment of full-cost water charges. In situations where water delivery charges are contractually or customarily levied on a per-acre basis, full-cost charges shall also be assessed on a per-acre basis. In situations where water delivery charges are contractually or customarily levied on a per acre-foot basis, one of the following methods must be used to assess full-cost charges:

(1) *Direct assessment.* In situations where measuring devices are in use to reasonably determine the amounts of irrigation water being delivered to full-cost and non-full-cost land to the satisfaction of the Secretary, assessments shall be based on the actual amounts of water used.

(2) *Proportional charges.* In situations where, in the opinion of the Secretary, measuring devices are not a reliable

method for determining the amounts of water being delivered to full-cost and non-full-cost land, then water charges must be based on the assumption that equal amounts of water per acre are being delivered to both types of land during periods when both types of land are actually being irrigated.

(i) The application of rules pertaining to the assessment of full-cost charges may be illustrated by the following:

Example (1). Farmer A, a qualified recipient, owns 960 acres receiving irrigation water in Alpha Irrigation District. Farmer A also leases 100 acres receiving irrigation water in Alpha Irrigation District from another party. Alpha Irrigation District's repayment contract specifies an annual assessment of \$5.00 per irrigable acre. Alpha Irrigation District's annual full-cost rate is calculated to be \$15.00 per irrigable acre. Therefore, Farmer A's total water charge for that year is (960 acres × \$5.00) plus (100 acres × \$15.00), for a total of \$6,300.

Example (2). Farmer B and his wife own 320 acres receiving irrigation water in Beta Irrigation District and lease another 320 acres receiving irrigation water in the same district. Farmer B, his wife, and Beta Irrigation District all remain subject to prior law. Beta Irrigation District's water service contract specifies a rate of \$10.00 per acre-foot, and its full-cost rate is calculated to be \$25.00 per acre-foot. Farmer B has a turnout and measuring device to the 320 acres he has selected to pay full cost, and a separate turnout and measuring device to the 320 acres receiving water at the contract rate. At the end of the water year, district records show that Farmer B received 1,000 acre-feet of water on his full-cost land, and 1,050 acre-feet of water on his non-full-cost land. These measurements are judged to be accurate and reliable; therefore, Farmer B's water charges for that year are (1,000 acre-feet × \$25.00) plus (1,050 acre-feet × \$10.00) for a total of \$35,500. If accurate records showing the amounts of water delivered to Farmer B's full-cost and non-full-cost land had not been maintained, it would have been necessary to assume that equal amounts of water per acre had been delivered to both types of land. Without accurate water delivery records, Farmer B's water charges for that year would have been (1,025 acre-feet × \$25.00) plus (1,025 acre-feet × \$10.00) or \$35,875.

Example (3). Farmer C, a qualified recipient, leases 1,000 acres in Gamma Irrigation District where the contract rate is \$5.00 per acre-foot, and the full-cost rate is \$15.00 per acre-foot. Farmer C applies irrigation water to 960 acres and irrigates the remaining 40 acres from a private well. In one particular year, Farmer C applied water to the land six

times during the irrigation season; but in the final two applications, his well failed, so he chose to apply irrigation water to his entire landholding. Because there were no separate measuring devices for the 40 full-cost acres, it was necessarily assumed that equal amounts of water per acre were applied to the full-cost and non-full-cost land during the final two applications of water. Gamma Irrigation District's record showed that 600 acre-feet were delivered to Farmer D during each of the first four applications, and 625 acre-feet during each of the last two applications. Farmer C's water charges for that year were calculated as follows: The first four applications did not include any full-cost water; therefore, the appropriate charge was $(4 \times 600 \text{ acre-feet} \times \$5.00)$ or \$12,000. The final two applications were 96 percent contract rate and 4 percent full cost. Thus, the appropriate charges were $(2 \times 625 \text{ acre-feet} \times .96 \times \$5.00)$ plus $(2 \times 625 \times .04 \times \$15.00)$, or \$6,750. Farmer D's total water charge for the year was \$12,000 for the first four applications plus \$6,750 for the last two applications, for a total of \$18,750.

(h) *Disposition of revenues obtained through full-cost water pricing.* The interest and full-cost revenues, less the appropriate non-full-cost rate, shall be credited to the Reclamation fund unless otherwise provided by law. The portion of the full-cost rate, which would have been collected if the land has not been subject to full cost, shall be credited to the annual payments due under contractual obligation from the district.

[52 FR 11954, Apr. 13, 1987, as amended at 53 FR 50536, Dec. 16, 1988]

§ 426.8 Operation and Maintenance (O&M) charges.

(a) *Districts with new or amended contracts.* A district which becomes subject to the discretionary provisions as set forth in § 426.5(a) (2) and (3), will be required to pay annually the actual O&M costs chargeable to the district. They are to be paid to the United States on a schedule that is acceptable to the Secretary. O&M costs shall include minor replacement costs for facilities funded during the year. Each year the Secretary shall estimate and advise the district of its O&M charges, and the price of irrigation water will be modified, if necessary, to reflect any changes in O&M costs. The difference between the estimated and actual O&M costs, as determined at the end of the

annual period, will be reflected through adjustment of the following year's O&M charges. One effect of this provision is that if a district's contract rate, less the O&M costs of delivering water, is positive at the time a district amends its contract solely for the purpose of becoming subject to the discretionary provisions, as set forth in § 426.5(a)(3)(i), that positive difference will continue to be paid annually to the United States, in addition to any adjusted O&M costs, during the remaining term of the contract. Major replacement costs, such as those caused by disaster, obsolescence, or otherwise, will be capitalized under regular Bureau accounting practices.

(1) The principles of this rule may be illustrated by the following:

Example (1). A district amends its water service contract to conform to the discretionary provisions. Prior to its amendment, the water service contract obligated the district to pay a fixed rate of \$3.50 per acre-foot for water for the remaining 10 years of its 30-year contract term. At the time of contract amendment, \$3.00 of the contract rate are needed to pay current O&M costs. If the district's O&M costs increase by \$0.50 per acre-foot from \$3.00 to \$3.50 per acre-foot in the year after the district's amendment, then the current \$3.50 rate will be adjusted to \$4.00 to reflect the \$0.50 increase in O&M costs. If the district's O&M costs increase by \$0.25 per acre-foot the following year, the district's rate would be \$4.25 per acre-foot. Similar adjustments to O&M costs would continue throughout the remaining term of the district's contract. One effect of these adjustments is that, subsequent to amendment and continuing throughout the remaining contract term, the district's annual payments will be \$0.50 per acre-foot higher than its actual O&M costs.

Example (2). A district amends its water service contract for the sole purpose of conforming to the discretionary provisions. Prior to its amendment, the district's contract obligated it to pay a rate of \$3.00 per acre-foot of water for the remaining 10 years of its 30-year contract. At the time of the contract amendment, the district's actual O&M costs are \$6.50 per acre-foot. Since the current contract rate of \$3.00 does not cover these O&M costs, the district's rate will be increased to \$6.50. If the district's O&M costs increase by \$.50 per acre-foot the following year, the district's rate would then be adjusted to \$7.00 per acre-foot.

Example (3). A district's repayment contract obligates it to pay \$4.00 per acre for the remaining 5 years of its 40-year contract. It